Memorandum

Subject [redacted]	Date June 7, 1995 7D

To File From Wendy Saltzman

On Wednesday June 7, 1995, Kate Balaban and I met with [redacted]

I. Background Information

[redacted] 7D

II. Market Definition

The salted snack market includes potato chips, tortilla chips, corn chips, popped popcorn, extruded chips (e.g. cheese curls), pretzels, meat snacks (pork rinds), party mix and multigrain chips. It may also be expanded to include peanuts and unpopped popcorn, [redacted] (b)(5) 7D

[redacted] explained that the market can be defined from three different stand points:

1) Consumer Standpoint- Each product con~~stitutes~~ ~~its own separate~~ market. If a person walks into a store and wants Gold Rim

Pretzels, s/he is more likely to substitute another brand of pretzels if Gold Rim products are unavailable, than to buy a totally different snack food product.

2) Manufacturer Standpoint- All salty snacks are included in the snack food market. All manufacturers who are competitive in the snack food business produce a variety of these different products, and distribute them as one product. However, the machines which produce these products, as well as the product inputs, are varied and limited in substitutability, which suggests that the various types of snack foods could be considered in different markets.

3) Stores/Retailers Standpoint- All salty snacks are included in the snack food market. They sell space ~~according to brand,~~ not by individual product, and profitability is recorded according to company name.

The geographic market was not clearly defined, but many of Frito Lay's competitors, including [redacted] appear to be regional distributors rather than national in scope. 7D

III. [redacted]

[redacted] 7D

In order for [redacted] to maintain a profitable direct store delivery distribution system, ~~a normal route~~ would have to generate between [redacted] in product sales. Routes vary in size according to geographic region and the density of demand in the area. Costs for distribution include the cost for the vehicle and the cost for personnel. If route profitability falls beneath these lines then the areas route will be closed, and eventually entire regions will be removed from the route distribution map. Companies which cannot b5, 4, 7D maintain profitable sales in an adequate number of distribution routes either face closure or sale to private label companies (store brand names).

IV. Cost Structure

[redacted] admits that Frito Lay is run on a different cost structure than the smaller firms because of its sheer size. Frito Lay has buying opportunities, and a competitive position not available to regional manufacturers, which legitimately gives it a significant cost advantage. However, [redacted] maintains that Frito Lay also uses the size factor to manipulate the market in a harmful way for its competitors.

7D

For instance, in 1991? when potato growers experienced a bad crop year, Frito paid $25, three times the normal rate, for a 100 pound bag of potatoes, a price which few other manufacturers could match. [redacted] believes that Frito Lay purposefully set the rate high so that other snack food producers would have to wait for the costs of potatoes to go down before they could restock the stores. This tactic was successful in preventing the smaller companies from production for a week or two as [redacted] believes Frito Lay had intended. In past years Frito has executed similar programs to obtain other inputs such as peanut oil.

V. Frito Lay's Exclusionary Tactics

[redacted] alleges that Frito Lay has engaged in certain exclusionary conduct, the objective of which is to weaken or eliminat its competition rather than on benefiting the consumer. One type of such conduct is the payment of slotting fees to retail stores in exchange for contracts that guarantee Frito Lay exclusive rights to sell all of the snack food products in the store. These contracts are usually one-time fees, and the contracts do not usually specify a time frame. [redacted] said that these exclusive contracts are fairly permanent agreements which are only threatened if another company contracts with the store paying a higher amount for the space. Shelf space is bought for between [redacted] per vertical square foot for a one time semi-permanent position. This makes the snack food isle one of the most profitable slotting fee isles for the retail outlet.

7D

(b)(4)

Stores that are concerned with maintaining variety and who are not dependent on snack food slotting fees for survival do not generally enter into these types of exclusive agreements. If Frito Lay is unable to negotiate an exclusive agreement with a store then it often tries to obtain exclusive rights to "end shelves", which are the prime locations in stores. Frito Lay also contracts for exclusive promotions rights during peak selling areas during the year, for supplemental display case areas, and for exclusive rights to sell particular sizes of chip bags, such as single serve bags.

[redacted] TD

In addition, in stores where Frito Lay has exclusive agreements or near exclusive agreements under which it has acquired more shelf space than it can fill, Frito has a practice of "dummying-out" the shelve space. "Dummying-out" is where the shelve space is only filled in the front half, with the back section of the shelf being filled with boxes or wire to make it appear as though the shelve is totally stocked with the product.

Another program instituted by Frito Lay is called the "Apollo Space Program," which is a program aimed at procuring custodial positions in stores to give Frito Lay the advantage in levying for store space. [redacted] explained that the snack food industry is in charge of delivering and stocking its own products on the shelves in stores. They are also in charge of managing the snack food isle, to make sure shelves are set up correctly and not broken, ect. One company is placed in charge of managing custodial work in the snack food isle of a store, and by doing so, the company usually maintains a better working relationship with the store owner. Recently, Frito Lay has been aggressively seeking custodial management positions so that they will be in a better position to bid for shelve space. Custodians also help organize the movement of companies within allocated of shelve space, although it appears as though they do not have any significant impact on the actual allocation decision.

VI. Degree of Foreclosure

According to [redacted] these exclusionary tactics are being used by Frito Lay in hopes that it will erode competitors market share enough to make it inefficient for them to compete further in the snack food business. Laura Sudder, Granny Goose and Nibble with Gibble have all folded under Frito Lay's pressure. In the Southwest Frito Lay has been successful in closing down the competition and has been able to obtain exclusive dealing arrangements with the Winn Dixie supermarket chain, now competing only with the store/private label brand. Frito Lay's growing market share has given it the leverage to "call the tune on pricing," but there is no evidence that Frito Lay has begun to significantly alter the prices charged for its products. 7D

[redacted] was unable to define how foreclosure in the market should be measured: by the exit of snack food brands from shelve space, stores, distribution routes, ect.